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DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

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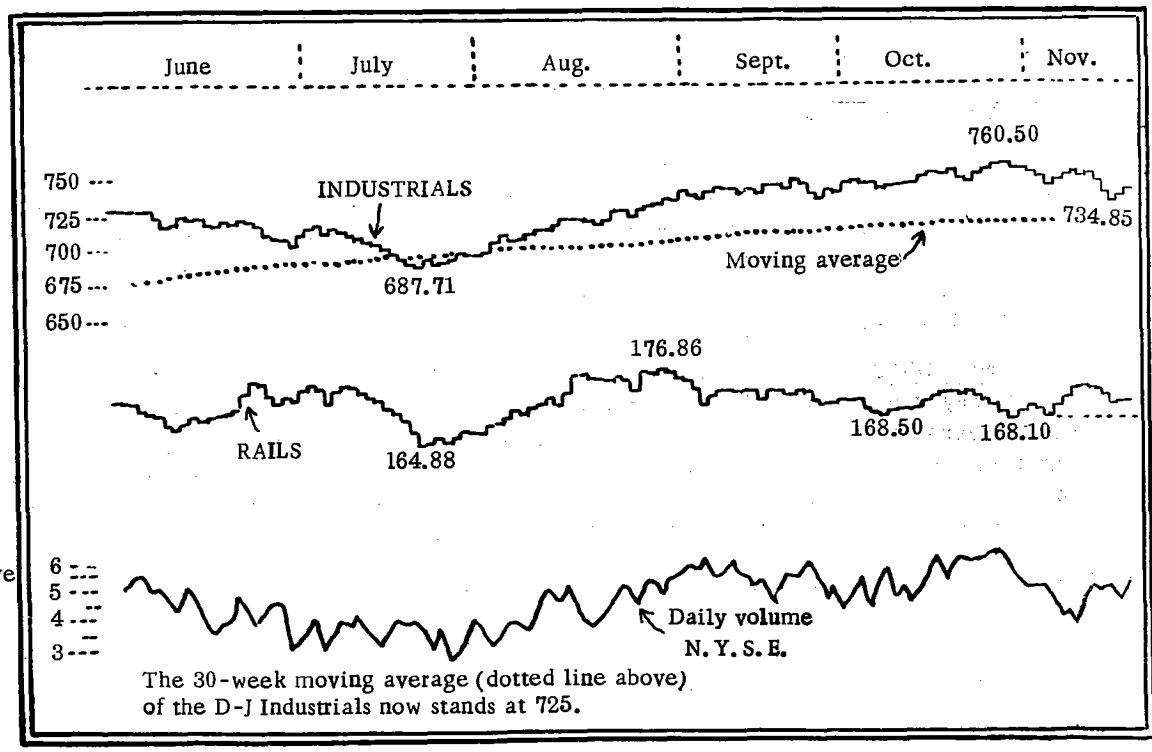
THE MARKET Records going back to 1919 suggest that when price (Industrial Average) and breadth (advance-decline ratio) get "out of "gear", trouble is brewing somewhere ahead. In 1929, it took 48 days for the divergence between price and breadth to turn the Industrial down. In 1937 a divergence continued for 39 days before Industrials recorded their final top. In 1948 it took only 14 days, in 1957 it required only 36 days. The A-D ratio touched a high on March 31, 1959, and it took 99 days for Industrials to record a peak (August 3). The period of March-August, 1959, represented the longest divergent period in the record. As if to make up for this, the A-D ratio began another full divergence on December 8, 1959, and this time the Industrial Average "topped" only 18 days later -- on January 11, 1960. A tabulation of all previous price-breadth divergences shows that the average number of days which elapsed between the beginning of the divergence and the final peak on the Industrial Average was 31 days.

Undoubtedly, the current price-breadth divergence has been subject to more publicity than any other such phenomenon in market history. This wide recognition of a bearish situation by the investment fraternity has probably been responsible for putting off the trouble which this writer felt "should have" materialized around the end of September.

Following the August 30 peak of 176.86, the Rail Average went into a persistent decline (please study Chart #1). On October 9, Rails broke to a September-October low of 168.50, thus violating all September Rail levels. This move was not confirmed by Industrials, however, and a rally followed. On October 30, Rails sank to a new low of 168.10, and again Industrials refused to confirm. A second rally took place.

On November 11, Industrials themselves turned weak, and during the space of five days the senior Average plunged below all October and November lows. At this point, the Rails refused to confirm the Industrial weakness. As seen on Chart #1, the carriers held stubbornly above their October 30 low of 168.10. It was also noticeable that volume on the decline of November 11-18 did not (on any single day) rise above 4.8 million shares. This lack of heavy downside volume together with the Rail non-confirmation called for at least a corrective rally.

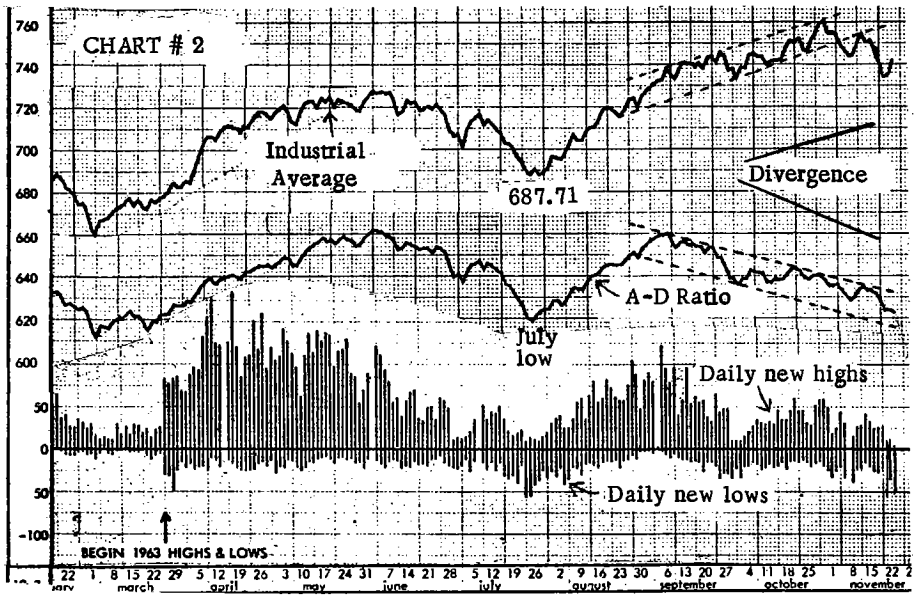
On November 19 a rally began, but the market gave an amazing performance. After being up over 5 points at noon, Industrials closed up a little over a point, Rails gained 45¢, 31 more issues declined than advanced, and new lows outnumbered new highs by two to one. The market rally of November 20 was even more incredible. On the news of a split in Telephone, Industrials closed up 5.51, Rails (which had resisted on the recent decline) edged up 12¢, 58 more issues declined than advanced, and new lows bettered new highs by 51 to 19. "A few more days of this kind of rally," said a New York caller, "and we'll lose our shirts."



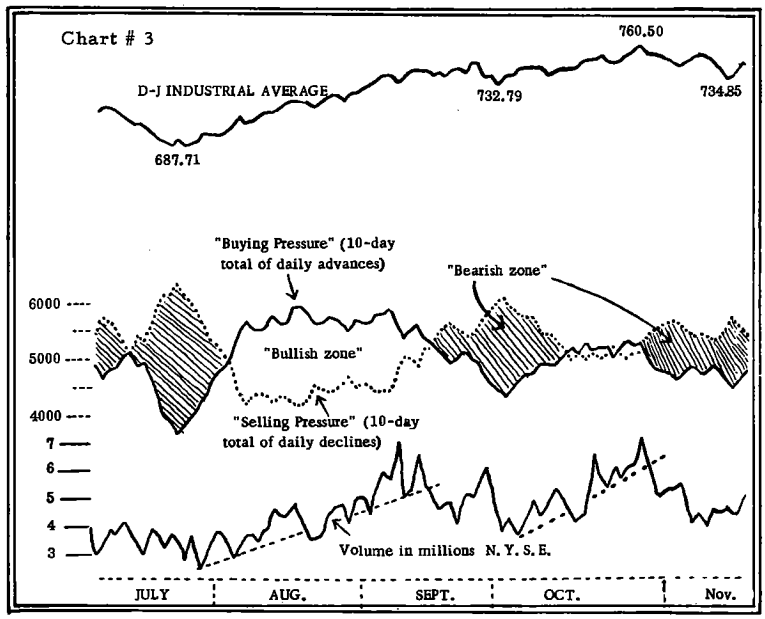
The 30-week moving average (dotted line above) of the D-J Industrials now stands at 725.

Against a background of broad technical deterioration, any near-term guessing at fluctuations would be fruitless on my part. The following thoughts, however, should be kept firmly in mind: (1) Further authoritative downside action by the Averages must entail a violation of the 734.85 (November 19) low on

Industrials, and most important -- a breaking of the 168.10 (October 30) low on Rails. A decline from here would not be significant from the bearish standpoint unless both of those levels were violated. (2) Volume has been a particularly good indicator of late. Since September, the trend of volume has been to expand on declines and contract on rallies. Such indications are, of course, bearish. As long as volume behaves in this way, our approach to the market must remain negative.



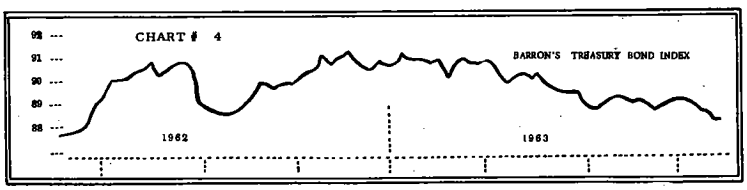
On November 18 the A-D ratio came within striking distance (see Chart #2) of its July low. If further weakness results in the A-D ratio dropping below its July low, the Industrial Average will have to "decide" whether it is going to confirm by plunging below its own July low of 687.71 -- or whether it is going to resist. I had felt that a year end rally could be set off by a penetration of the July low by the A-D ratio -- unconfirmed by the Industrial Average. If further immediate weakness develops, we will have to watch the Industrial Average and the A-D ratio with utmost care. As stated in Letter 236: "A downside penetration of the July low by the A-D ratio, unconfirmed by Industrials, could lead to a good rally (perhaps to a new Industrial high). This is exactly what occurred in late-1959. On the other hand, if the A-D ratio breaks its July low and Industrials confirm, we will have a situation which will appear more like 1962 than 1959."



BUYING AND SELLING PRESSURE (Chart #3). The latest "bearish zone" began on October 24 when Selling Pressure rose above Buying for the second time since mid-September. Note that following the September-October bearish zone, there was no sign of revived Buying Pressure. Instead, the two lines overlapped for a few weeks, and a new attack by the bear forces followed. This is a most unusual phenomenon, and it is generally brought on for the following reasons: When an advance extends "too far", it begins to attract informed selling. The higher prices go, the more traders and investors are attracted to the selling side of the market. As a rule, only one thing will cause the sellers to cease their selling and become buyers again -- and that is a substantial decline.

Although many stocks have retreated since September, the September-October decline was evidently not sufficient to satisfy the powerful selling forces in this market. Following the bearish zone of September-October, the sellers "paused" for a few weeks (during late October). But on October 24 the sellers became active again -- as seen by the latest bear zone. The September-October bear zone took the Industrial Average back to 732.79. The most recent bear zone pushed the Industrials down to a November 19 low of 734.85. As a guess, I do not think the most recent low of 734.85 will satisfy the sellers any more than did the 732.79 low of September 31. I think the Industrials will go considerably lower before the sellers are finally satisfied.

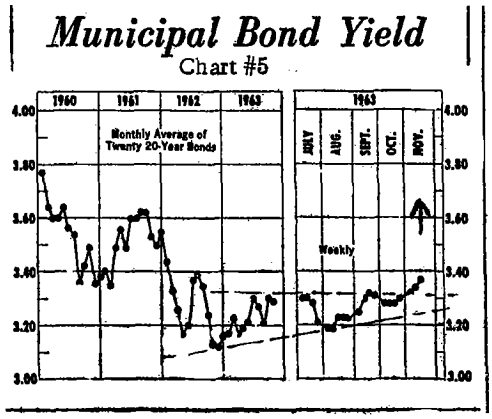
BONDS AND MONEY While the average yield on common stocks (3.1%) remains within the confines of the lowest levels in market history, the story in the bond market is becoming increasingly interesting. Chart # 4 (below) traces the path of Barron's Treasury Bond Average over the past two years. Treasuries turned down during the last quarter of 1962 and have been going down ever since. During the current month of November, Barron's Treasury Average sank to its lowest level since mid-1962. U. S. Government bonds are currently providing historically high yields (for instance, the great majority of maturities of 1968 and beyond are now yielding upwards of 4%).



Moreover, as chart #5 (page 3) from the Wall Street Journal shows, the average yield on tax-free municipal bonds has recently risen out of its 1963 area to climb to the highest levels since mid-1962. Tax-free municipal bonds, on

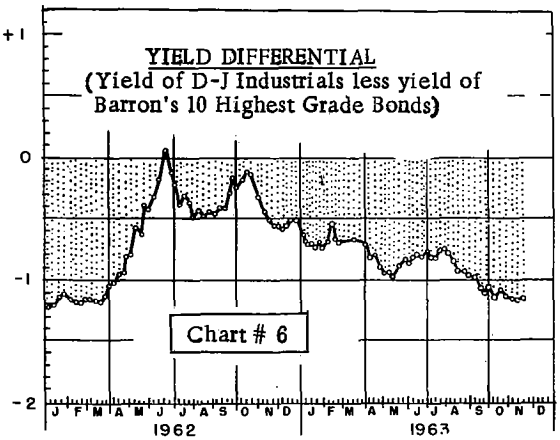
average, are now providing a better return than common stocks.

Chart # 6 shows the negative (and historically abnormal) differential between the yield on the D-J Industrials and the yield on Barron's Highest Grade Bond Index. Few people realize that despite the drop in bonds, the yield differential has now sunk to its most adverse level in almost two years. (Chart #6 courtesy of Merrill Analysis, Box 228, Chappaqua, New York).



It is important to realize that the continuing pressure on interest rates in stemming, not from Washington, but from forces outside the U. S. Within the past month, for instance, Belgium has raised the discount rate from 4% to 4 1/4% while France has increased her discount rate from 3 1/2% to 4%. This means that the U. S. (with a 3 1/2% discount rate) is again beginning to lag behind the rest of the Free World as far as interest rates are concerned.

A final comment on the money situation comes from Dr. Sloan Wilson of Kansas City. He writes: "Interesting times; history does repeat but not in exactly the same way. In 1928-29 industrial firms sent money to New York to take advantage of the high call rate. In the November 5 Wall Street Journal there is an article which states that industrial firms are again assuming greater risk for higher interest rates. Time deposits in Mexico, Italy, Japan, purchasing of preferred stocks of other firms for tax advantages; history does repeat. Credit is an expression of confidence, but the picture can change in 30 days. Charles Dow knew this."


YIELD DIFFERENTIAL
(Yield of D-J Industrials less yield of Barron's 10 Highest Grade Bonds)
+1
0
-1
-2
Chart # 6
J F M A M J J A S O N D J F M A M J J A S O N D
1962
1963

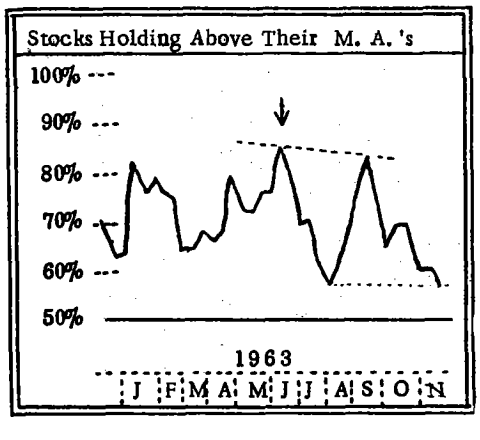
SUNDRY COMMENTS The latest statistics from the Federal Reserve show that the nation's Industrial production rose to an all-time high of 126.6 in October. Despite this and a veritable "shower" of good news (i.e., the Chrysler split, the G. M. extra, the DuPont distribution, the Telephone split), readers of these Letters know that the majority of stocks saw their aggregate best levels on May 31, 1963 (at which time the A-D ratio recorded its peak). When the market is at variance with the prevailing news -- it pays to be on guard. A market that will not respond to bright financial headlines is a market that has fully discounted the good news.

More recently, the market has been highly sensitive to any suggestion of adverse news. On the report of a dip in auto sales last week, the auto stocks broke badly. A few days later the oil stocks fell sharply on reports of price cutting wars in the U. S. and expropriation of oil property in Argentina.

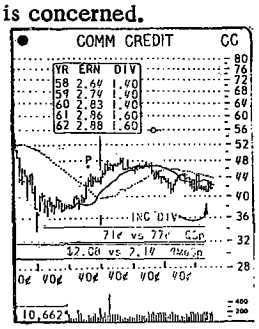
* * * * *

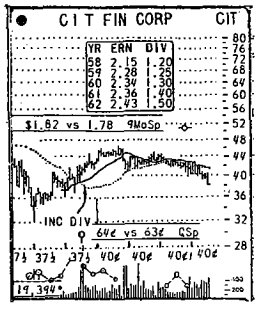
With the raising of stock margins from 50% to 70% on November 6, many analysts became optimistic -- based on the observation that when margins were raised in the past, stocks responded first by declining, then by rallying to higher levels. But James Hughes of New York comes up with a fascinating observation: the recent action represents the first time since 1945 that margin requirements were raised when the breadth-price relationship was unfavorable. In all other instances (i.e., February, 1945; January, 1946; January, 1951; January and April, 1955; August and October, 1958) the trend of the Industrial Average and the A-D ratio was in bullish harmony and therefore favorable to higher prices.

STOCKS Of 432 representative stocks tabulated at this office weekly, 250 or 58% are holding above their 200-day moving average (a drop of 3% from last week). This is shown on the little chart at the bottom of the page. The percentage holding above their moving averages has now dropped to exactly the late-July level which represented the lowest level of the year. A decline below 50% will constitute a major danger signal as far as this study is concerned.



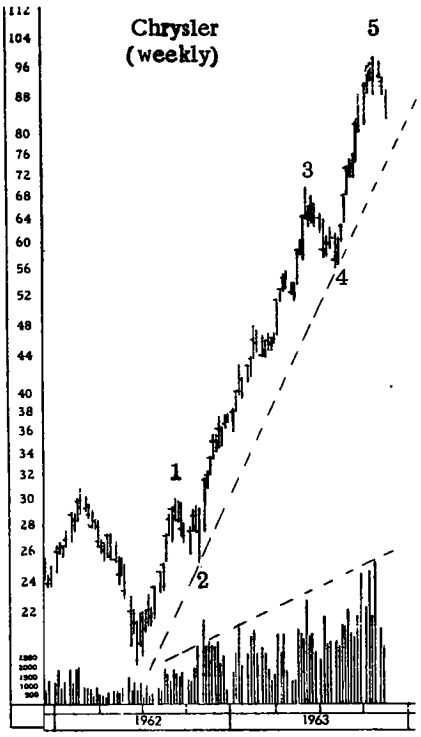
The ways of the market never cease to be fascinating. In Letter 235 I included charts of twelve leading finance companies, and I commented that the trend of all these stocks was down. I again include weekly charts of two of the leading auto finance companies, CIT and





Commercial Credit. Both of these issues have been in pronounced downtrends for many months. If the leading auto finance companies have turned bearish, one wonders what the implications are as far as continuing record auto sales are concerned.

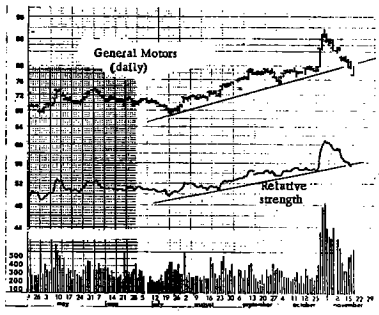
Last week a mere hint of sliding sales sent the auto stocks sharply lower. The daily chart of G. M. shows the stock exploding from 80 to 91 3/8 on massive volume, then plunging to 76 1/2 on continuing huge volume. GM has broken its most recent trendline, and I would guess that its high is going to stand for some time. The weekly chart of Chrysler shows the remarkable 1962-63 "stilt formation" and the most recent decline. The main trendline in C is drawn, and it would take a drop to the 70-72 area to shatter this trendline. Nevertheless, note the well-defined five-step advance in C from its 1962 low. Such a five-step pattern often marks the completion of a bull movement. The steadily increasing volume in C throughout the rise also suggests increasing public (rather than investment) participation. All in all, I would not count on the motors to lead the Industrial Average higher from here.



I have included two monthly Utility charts, Detroit Edison and Consumers power. These are interesting because they show the reversal of a five-year upward trend in relative strength Utilities are not attractive now, and though they may be sluggish as short sales, they should be not be counted on to resist during any forthcoming general market decline.

Two stocks that will bear watching are Baldwin-Lima and General Tel. & Electronics. Baldwin, after consolidating for over a year, is beginning to act better than the market (see R. S. breakout on chart). Gen. Tel. has been acting mildly better than the market since mid-1962. If this stock's R. S. line were to push through the upper line of the current channel, it would suggest dynamic improvement in the stock.

The supervised account held three stocks (all long) as of last week. This week Emerson Radio was "stopped out" at 12 for a 1/2 point loss. This leaves Jones & Laughlin at about a 1/2 point profit and Goodyear at a 1 1/2 point loss. When the trend of the A-D ratio is down as it is now, sooner or later almost all stocks go down and those with superior R. S. simply decline less than the others. For this reason and for the reason that I believe a really superior buy-spot will probably appear within the next few months, I am advocating sale of all stocks. A new account will be started when the market reaches what I believe is an advantageous buying area.



LATE NOTE (Written Thursday, November 21, noon N. Y. time): The market's grotesque performance following the Telephone split news appears to be too much even for the bulls to swallow. As this is written, Industrials are off 4 points, Rails are down .65 and volume is running above yesterday's figures. Yesterday's Telephone split news somehow reminded me of the steel strike settlement news in January of 1960. The market has been wallowing in good news -- but cannot come up with a single day of impressive performance.

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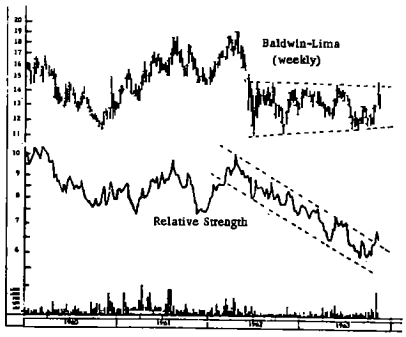
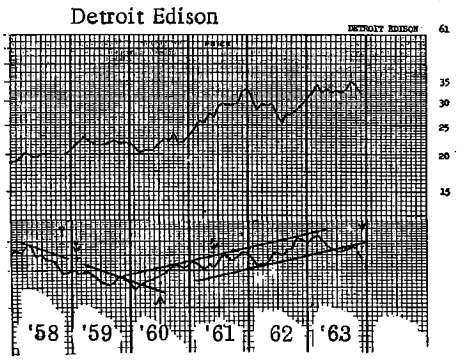


Charts of Consumers Power and Detroit Edison Courtesy of Ray * Signals, 141 Broadway, New York City 6. Charts of Comm. Credit and CIT courtesy of Quote Digest, 110 North Lorraine, Wichita, Kansas. Charts of Baldwin, GM and Chrysler courtesy of Traders Research, 1431 Pearl Avenue, Alton, Illinois 62003.

Detroit Edison



Consumers Power